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A THREAD

Topic: HOW TO TRADE IN RISING PREMIUMS SCENARIO

Option sellers specially Straddle sellers feel that rising premiums give them excellent opportunity to make easy money. So what they are seeing is the theta aspect of options & ignoring the delta/gamma/vega forces.

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With rising premiums come high delta moves. There is a reason why premiums are all increasing up in the first place. High uncertainty & fear is what's controlling the markets during such times. So a volatile 200 point move in nifty is always on the cards.

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Adjusting during such delta moves involves high slippages. Such costs go in our system & are irrecoverable. So if the ATM straddle is around 400 & after 200 point downmove, the next straddle is at 450 & the loss is not just 50points but compounded much more.

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Also there are chances that there is no decay throughout the day. So a straddle seller has to take that heavy risk of carrying it forward & chances of gap openings are high during such times. If converted into Ironfly, then the cost of the wings is too expensive.

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Thus cutting down the initial credit significantly.

There will also be very few instances when premiums don't fall till expiry day. So with each delta move the cost of holding a straddle gets accumulated & pressure keeps mounting for the stubborn option sellers.

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So what should be done during such times?

Compulsive straddle sellers can keep a close SL & do quick scalping. But such profits don't give you much satisfaction, as speculation element is high in such trades.

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Better way is to trade directional. If you have a little sense of market direction, then one can make good use of rising premiums.

There are many option strategies like Ratios, Ladder, even far OTM naked/spread selling which can give good opportunity to take advantage.

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The advantage can also be taken without directional knowledge. The bias that the premiums will fall in one direction & rise in another. Example if premiums are rising in a downmove, then Call Ratios or OTM calls can be sold. It's because they will not rise much in an upmove.

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All said, sometimes premiums do fall heavily during such times. But it's better to not try to sell them speculating that the top is made. It's better to wait it out & let the premiums settle a little. Then one can enter cautiously & with decent gains go agressive again.

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So basic crux is to find an objective system to follow the market. There are lot of forces at play in option selling, apart from THETA decay.

If one can find a way to forsee how volatility or direction is going to play out, then it's a different ball game altogether.

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Idea is to not get caught up in wild moves when premiums are unstable. If we do get caught, then we are not in a good vantage point to take advantage of inflated premiums.

Patience is the key & being ready to let go of some premium decay. Don't get caught up in FOMO.

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A good example is today (18/06/21). Premiums were giving repititive spikes since morning, with a big spike at 11am. The spikes were only in the downmove which is important observation.

In this scenario, we could have sold inflated OTM calls, which were not falling.

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We can also use strategies like credit spreads or skewed call ratios. So we are trading direction here with the premise that premiums will fall in the upmove.

When market bounced back calls also fell at first. If market starts rising, we can start neutralizing our position.

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We can do it in two ways:

• If IVs are falling then sell otm puts
• If IVs are increasing then buy higher delta calls to make Call ratios

The above example is when we want to trade directional & take advantage of rising premiums.

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For non-directional best was to not enter till 11:30am. We can't really know where the top will be made. So let the dust settle & premiums to start falling. Then we can slowly build our position & ride the falling IVs.

I traded in both the ways in different counters.

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The risk was IV spike in upmove for my directional position, for which i would have bought higher delta calls to protect.

Risk for my non-directional straddle was an IV spike at EOD, for which i exited early (much regret), as profit received was high in short time.

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